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SUBJECT: Argentina's 2010 Budget: New Tricks but Same Old Story

Ref: Buenos Aires 1161

Summary

¶1. (SBU) The 2010 Argentine budget does not represent a great departure from the budgets of past years during the Kirchner era. It pays lip service to fiscal restraint that is unlikely to be pursued in practice, and uses numerous accounting tricks and gimmicks to understate expenditures. However, the GOA's decision to initiate a deal with the "holdouts" from the 2005 debt restructuring agreement indicates that it realizes the need to normalize its relations with the international credit markets to enable easier borrowing to deal with the large fiscal gap likely to eventuate in ¶2010. End Summary.

Status of Budget

¶2. (SBU) On September 15, the GoA formally submitted the 2010 Budget Bill to the Congress for approval. Two days later, Minister of Economy Amado Boudou presented the main points of the bill to the Chamber of Deputies. The Lower Chamber approved it on October 14 and the Senate is debating it now. Along with the budget bill, the Chamber of Deputies approved amendments to the Fiscal Responsibility Law and the extension of several taxes for another year. The Senate will take up these issues as well.

Budget Bill Assumptions

¶3. (SBU) The budget assumes GDP growth of 2.5% in 2010, in line with many private estimates and even more conservative than some, whose estimates range up to about 3.9% growth in 2010 versus a contraction of up to five percent in 2009. The bill revised the GOA's original 2009 GDP growth estimate downward from 4% to 0.5%. The CPI is assumed to come in at 6.1%, significantly lower than most private estimates, which expect inflation of about 15% for 2010. The inflation figure put out by the GOA's statistical agency INDEC is the one most criticized by many private analysts, reflective of continued widespread dissatisfaction with INDEC'S methodologies.

Exchange Rates

¶4. (SBU) The average exchange rate assumed in the budget bill is 3.95 ARP/USD. The peso has recently exhibited unexpected strength vis-`-vis the dollar due to a variety of factors, including the initiation of negotiations to resolve the holdout problem and a rise in dollar-denominated purchases of Argentine crops. While noting the recent strength of the peso, most private analysts still expect it to depreciate slowly over the next year, although the consensus

has moved away from earlier predictions of a sharp devaluation.

Trade Surplus

¶5. (U) The budget assumes a trade surplus of about $14.2 billion, with exports of $65 billion and imports of $51 billion. While this figure is similar to the surplus expected for 2009, the 2009 trade surplus is a result of much lower absolute levels of both exports and imports ($57.8 billion and $43.6 billion, respectively). Some analysts contend that the 2010 export figure is understated due to the expected return to normal of the 2010 harvest after this year's severe drought, which could produce upwards of 25 million tons more of available crop (mainly soy).

Consumption and Investment

¶6. (U) Consumption is forecast to increase 2.7% y-o-y after increasing only 0.9% in 2009, while investment is expected to jump 8% y-o-y, substantially recovering from its 9% decline in 2009. Investment could reach 23% of GDP -- similar to its 2009 level.

Revenue Assumptions

¶7. (SBU) Total public sector tax collection is projected to increase 16% y-o-y to ARP 353 billion, increasing slightly to 28% of GDP in 2010 from 27% in 2009. This increase in tax collection appears achievable given the expected recovery of economic activity and continued high inflation. The GOA's 2010 tax structure remains similar to this year's, and assumes the continuation of all taxes, including the income tax, the wealth tax, the tax on the final price of cigarettes, the minimum presumed income tax, and the financial transaction tax (FTT). The Chamber of Deputies approved the

extension of these taxes on October 14 and the Senate is expected to approve the extension as well alongside the approval of the budget bill. (FTT tax collection -- estimated at ARP 23 billion in 2010 -- is divided 70-30, with 70% going to the Federal government and only 30% to the provinces. Provincial congressmen and governors have long requested that the FTT be equally shared between the GoA and the provinces, under Argentina's co-participation law.)

¶8. (SBU) Collection of export taxes is forecast to increase 35% y-o-y due to the expected increase in exports and continued depreciation of the peso. Income tax collection, however, is expected to increase only 8% y-o-y, less than the 15% inflation rate most private analysts forecast. Social security contributions are expected to increase 16% y-o-y, due to higher salaries and an increase in the number of people employed. This marks a return to normalcy compared to 2009's social security contribution increase of over 50% y-o-y as a result of the nationalization of private pension funds (AFJPs) in 2008.

Non-Fiscal Revenues

¶9. (U) Non-fiscal revenues are forecast to decrease 2.8% y-o-y to ARP 15 billion. These revenues are composed of: an ARP 3.8 billion BCRA quasi-fiscal surplus generated by interest earned on BCRA's portfolio and exchange rate gains, ARP 8.4 billion in interest earned on the Social Security Agency (ANSES) portfolio, and ARP 2.2 billion in interest earned on the Provincial Development Fiduciary trust.

Expenditures Keep Growing

¶10. (U) Total expenditures are expected to increase 12.4% to ARP 273 billion, about 22% of GDP, the same as in 2009. The bill also revises the 2009 expenditure target, which is the base for the 2010 budget figures, upward to ARP 243 billion as opposed to the projected ARP 233 billion projected in the original 2009 budget bill. Given that actual expenditures have increased at a 30% rate in the first seven months of 2009, expenditures for the remaining five months of the year would need to be drastically reduced to meet even the revised 2009 target. Given the rapid pace of growth so far in 2009, this is unlikely to happen, and most analysts doubt the ability of the GoA to similarly limit expenditures under the 2010

budget.

Subsidies Will Decline

¶11. (SBU) In contrast to the previous four years, in which transfers (subsidies) regularly doubled from year to year, they are expected to decrease 14% to ARP 31 billion in 2010. Only transfers to public companies and to the rural and forestry sector are expected to increase by 11% (ARP 2.6 billion) and 57% (ARP 1.5 billion), respectively. However, energy and transportation subsidies, which represent 44% and 32% of total subsidies, are pegged to decline 16% and 14%, respectively. Therefore, energy (electricity and gas) and transportation prices will increase in 2010, indicating an attempt by the GoA to unwind part of the subsidies web it has woven over the last seven years. Finally, interest expenditures are estimated to increase 8% to ARP 26 billion, about 2% of GDP.

Capital Expenditures

¶12. (SBU) Capital expenditures counted as part of the formal budget framework are expected to increase 14% to ARP 37 billion. In 2009, capital expenditures have already increased 50% in the first seven months of the year. However, the 2010 budget (article 17) allows the Ministry of Planning to account for priority social and economic infrastructure projects in areas such as transportation, energy, education, environment, and housing as assets rather than capital expenditures. This contradicts the Financial Administration Law that requires that investment or capital expenditure be accounted for as expenditures. Consequently, actual spending is understated given that financing for numerous major projects is not included in the budget. In addition, the bill allows the Minister of Planning to raise up to ARP 4.5 billion and USD 1.2 billion to finance those priority investments. Furthermore, article 56 allows the Minister of Planning to grant additional guarantees of up to ARP 2 billion and USD 5 billion to finance priority projects. Taking into account these potential expenditures by the Ministry of Planning, total actual expenditures could increase by about 25% rather than the

12.4% noted in the bill.

Financial Results

¶13. (U) According to the bill, the primary fiscal surplus will reach ARP 28 billion (or 2.3% of GDP) compared to ARP 15 billion (1.4% of GDP) in 2009. The overall surplus (after interest payments) will decline to a negligible ARP 620 million (0.06% of GDP) in 2010, after a deficit of ARP 9 billion (0.8% of GDP) in ¶2009. The bill calls on the GoA to continue with the financial strategy pursued in 2009 -- to capture the excess funds of other public entities through GoA debt issuance, using banking balances in official accounts at Banco Nacion and BCRA for short-term lending.

¶14. (U) Financing sources include: IFIs, whose net financing will reach USD 2.1 billion, as a result of new lending of USD 3.8 billion and amortization of USD 1.7 billion; an increase in BCRA short- term assistance to USD 770 million, using up the full amount of BCRA financing available to the Treasury; and net long-term bond issuances of $11 billion (gross issuance of $15 billion minus amortizations of $3.5 billion). These bond issuances do not imply market access, because the only entities likely to purchase them are public entities such as ANSES.

Normalize Relations With Creditors

¶15. (U) The bill also mentions GOA plans to make progress in normalizing relations with creditors -- both the holdouts who did not participate in the 2005 debt restructuring and the Paris Club -- in order to facilitate access to the international credit markets. The GoA has already taken its first steps towards normalizing relations with creditors with the Minister of Economy Boudou

announcing October 22 that the GoA is planning to reopen its 2005 debt restructuring (see reftel). Additionally, on October 26 the GoA submitted a bill to the Congress to suspend the so-called "Bolt Law" ("Ley Cerrojo") that prohibits the executive from reopening the 2005 exchange for creditors not participating in the 2005 debt exchange.

Provinces and the Fiscal Responsibility Law

¶16. (SBU) Articles 73 and 74 of the Budget Bill allow the GoA to financially assist provinces through the Provincial Development Trust. The trust allows the federal government to extend aid in order to reduce the deficits of provincial governments and pay the salaries due to civil servants. These clauses contradict the Financial Responsibility Law (FRL). Therefore, in concert with the passage of the budget bill, the Congress will also amend the FRL to allow for this assistance. The reform will allow the provinces to expand their spending, deficit, and debt issuance limits. The proposed changes, which will only apply in 2010 and 2011, will allow the provinces to increase spending above a threshold established by the law, to issue debt to finance current spending, and to increase total debt service above 15% of current revenues (excluding transfers to municipalities). [Note that the FRL, in effect since 2005, was part of the GOA's commitment to reach a formal agreement with provincial governors on reform of federal-provincial fiscal relations, under the GOA's IMF program.]

¶17. (SBU) These amendments come in response to next year's expected provincial deficit of more than ARP 10-12 billion. If the amendments are approved as is widely expected (the Senate has already done so), the provinces will be able to issue more debt and the GOA will thereby minimize the financing it provides to the provinces. It will also prevent provincial governments from acting on their threats to issue quasi-currencies. The Budget Bill does provide for new GOA financial assistance to the provinces of USD $2 billion via "Financial Assistance Programs" (PAF). This figure includes USD 3 billion in lending minus amortization payments of USD 940 million. Also, the budget allows the GOA to restructure provincial debt, including negotiating a write-down, delay, or rollover of provincial debts to the GOA.

Executive Spending Discretion Maintained

¶18. (SBU) As in previous budgets, the 2010 budget bill includes so-called "superpowers," which, along with the 2005 amendment to the Financial Administration Law, enables the Chief of Cabinet to redistribute spending without prior Congressional approval. From 2003 to 2008, the underestimation of growth and inflation resulted in excess revenues, which the GOA spent at its own discretion. This practice has been denounced by opposition congressmen and private analysts. Opposition Deputy Claudio Lozano has estimated that from

2003 to 2008 the GOA managed about ARP 85 billion without Congressional oversight.

Spend Now, Pay Later

¶19. (SBU) Unlike in previous years, extra revenues beyond those projected in the budget bill are not expected in 2010. The GOA therefore included in the budget bill an amendment to the Financial Administration Law (article 79) which allows paying for 2010 expenditures with revenues to be collected in 2011. As opposition Deputy Jorge Sarghini (a dissident Peronist) described it, "up to now the executive branch hid the surplus to spend at its own discretion. But now the executive shifts expenditures to the next fiscal year because it does not have the resources to pay for them. With this tool along with the off-budget accounting for capital expenditures, the GOA talks about a surplus that does not exist."

Comment

¶20. (SBU) Most analysts are skeptical of the GOA's ability and willingness to decrease the expenditure growth rate, as called for in the 2010 budget bill. The approach outlined in the 2010 budget would allow the GoA to continue to finance the budget with its own resources without access to the international capital markets by

using the BCRA's earnings and by taking advantage of the liquidity of the local financial system. These analysts maintain that the GOA will not be able to refrain from increasing the expenditure growth rate and will consequently have a large financing "gap," which can only be addressed by borrowing on the international credit markets. Therefore, the GOA's recent moves to try to resolve the "holdout" problem and pave the way to normalizing relations with global markets suggests that it too perceives a large fiscal gap that it will need to address with at least some outside financing.

¶21. (SBU) As in previous years, the GoA executive branch aims to maintain its "superpowers" to spend at its own discretion. However, this year, it is trying to go further than before by introducing new clauses and amendments designed to lift provincial spending and debt limits, change accounting rules to pay 2010 expenditure with 2011 tax collection, and build infrastructure without accounting for project spending in the budget. This relaxation of budgetary discipline, while politically advantageous, further undermines the transparency of the budget process and the credibility of the government's budget package. It will also likely lead to a considerably higher fiscal deficit than the one announced to the public, with attendant additional inflationary pressures. According to private estimates, the ARP 620 million budget surplus projected in the budget bill is, in reality, an ARP 8.7 billion (0.7% of GDP) deficit when properly accounted for. Without access to the international credit markets, this gap will be hard to bridge.

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